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SUBJECT: ZAMBIAN ELECTRICITY SERVICE PROVIDERS--ZESCO CHASTISED, CEC  
OVERSUBSCRIBED

Refs: A) Lusaka 44; B) Lusaka 22

11. (SBU) Summary. The Energy Regulation Board recently approved needed rate hikes for parastatal Zambia Electricity Supply Company (ZESCO) Limited for 2008, but made future increases contingent on better performance by ZESCO, which in the eyes of Zambian consumers, has failed to provide expected levels of service. The ERB noted ZESCO's inefficiency and encouraged it to find cheaper sources of capital to fund projects, which include construction of transmission lines to serve several mining ventures. Meanwhile, privately-owned Copperbelt Energy Corporation (CEC)'s first public share offering was oversubscribed, and the company, which until now has focused on distributing power to copper mines, has its eyes on a massive power generation project. If it wins approval to develop the project, CEC could provide needed competition to ZESCO. End summary.

#### Long-Overdue Electricity Rate Hikes

12. (U) In September 2007, ZESCO published proposals to raise the electric power rates (tariffs) charged to its customers, with proposed increases across different end-user categories that averaged 60 percent and went as high as 160 percent in some categories--not so shocking, considering that the last time a hike in charges and fees for electricity was approved was 1998. ZESCO stated that the large rate increases were needed to cover increasing operating costs and to enable it to make capital investments. Many stakeholders submitted comments to the Energy Regulation Board (ERB), which in December 2007 announced that it had approved rate hikes, but at levels below ZESCO's request. In making its decision, the ERB took into account comments from Zambian stakeholders and analysis of the cost of providing electricity service conducted by a UK-based energy consultant funded by the World Bank and the Swedish government.

13. (U) In a public statement, ERB Chairperson Sikota Wina summarized key findings of the Board, including:

- ZESCO's quality of service has deteriorated.
- ZESCO needs to increase its budget for maintenance costs.
- ZESCO's staff costs are the largest of ZESCO's cost component and are too high, and the low electricity rates charged to ZESCO employees are prone to abuse.
- ZESCO should implement a more transparent load shedding policy, to give its customers some notice, to the extent this is possible.
- ZESCO needs higher rates to enhance financial viability and enhance security of supply of electricity in the nation.
- ZESCO needs to put in place measures to access cheaper sources of capital to finance its capital expenditure program.

14. (U) The new electricity rates took effect January 1, 2008 (Ref B). The approved increase ranges from 1.3 percent for commercial customers (whose former rates were considered to reflect costs

accurately) to 26.8 percent for residential customers and 27.5 percent for "Large Power" consumers in 2008. The ERB also approved conditional increases for 2009 and 2010, with the highest increases occurring in residential customers' rates. In order to attain the increases in out-years, ZESCO must achieve or exceed performance benchmarks on which it has agreed with the ERB. ZESCO representatives warned that ZESCO would not be able to implement major capital projects as a result of the lower-than-requested rate hikes, displaying a disinclination for tapping other sources of capital, such as a share issue, that would also bring requirements for better performance and greater transparency.

15. (SBU) Comment. Although a hike in electricity rates was needed, ZESCO's so-called "commercialization" in lieu of privatization has not resulted in greater operating efficiency of the parastatal, which maintains a monopoly over many aspects of the power sector in Zambia. In Post's experience, ZESCO's service record has been consistently below standard and undependable, characterized by inaccurate billing, slow response times, poor workmanship, and shoddy equipment. ZESCO representatives complain about their lack of resources and regularly request Embassy assistance, such as transportation for their technicians, paper for their billing department, and critical equipment (cables, transformers).

16. (SBU) (Comment Cont.) Not surprisingly, the Zambian public was outraged by the proposed rate hikes, as residential consumers have experienced a deterioration rather than an improvement in service in recent years. Local media reported that one member of Parliament commented that many of the poorer residents in his constituency could not afford to pay higher rates, and would resort to cutting down firewood illegally, "contributing to deforestation." It is heartening that the ERB criticized ZESCO publicly and made rate hikes in 2009 and 2010 contingent upon better performance by ZESCO. End comment.

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Copperbelt Energy Corporation: Successful Shares Offer, Future Generation Project?

17. (U) Copperbelt Energy Corporation (CEC) distributes power to major copper mining ventures located in the traditional Copperbelt of Zambia. CEC is owned by a group of primarily Zambian investors, whose Netherlands-registered corporate entity, Zambia Energy Corporation, bought out the interests of U.S.-based Cinergy and UK-based National Grid in 2006. Cinergy (now called Duke Energy) and National Grid originally acquired the company in a 1997 privatization deal. CEC buys power from ZESCO under a Bulk Supply Agreement (BSA) that is in effect until 2020; ZESCO recently raised the power rates charged under the BSA, reportedly by 27 percent. In early January 2008, CEC was continuing discussions (and, per local press accounts, close to reaching agreement) with mining companies about rate increases under the long-term Power Supply Agreements, through which CEC supplies power to many of the copper mines in central-northern Zambia: Chibuluma Mines, NFC Africa Mining, Chambishi Metals, Mopani Copper Mines, Luanshya Copper Mines and Konkola Copper Mines.

18. (U) CEC in November 2007 offered 100 million shares for sale to institutional investors, its employees, and the Zambian public, in its first listing on the Lusaka Stock Exchange. The share offer ended in mid-December 2007 and was oversubscribed. CEC's principal assets are primary transmission, emergency generation, and bulk distribution equipment. Its network was purpose-constructed to supply and distribute electric energy to the traditional mining sector, and spans approximately 6000 square kilometers. It includes 36 substations and accounts for about 50 percent of the electrical power consumption in Zambia. CEC has invested in maintenance and upkeep of its distribution and transmission assets and continues to replace older equipment that is coming to the end of its operating life. CEC's modest generation capacity consists of six gas turbines alternators, which provide 80 megawatts (MW) of back-up generating capacity. If there is a complete loss of power from ZESCO, the gas turbine alternators can operate for a limited period in "island" mode to allow mining operations to evacuate personnel from underground and other plants, to shut down plants in an orderly way,

and to maintain essential services.

¶9. (SBU) According to Executive Chairman of CEC and Managing Director of Zambian Energy Corporation, Hanson Sindowe, CEC also has joined forces with Mopani Copper Mine (a potential end-user of the power produced) to propose to the GRZ a plan to develop the Kafue Gorge Lower hydropower station (Ref A). The project would cost about one billion U.S. dollars and would generate 750 MW. Part of the project involves exporting power to two mines (with linkages to Mopani) across the border in the DRC. CEC would oversee the project, and has hired an energy sector consultant to assist with both the design and future tendering. CEC plans to contract out the construction of the project if it wins GRZ approval.

#### Biofuel-Powered Options Under Consideration

¶10. (SBU) Sindowe told Emboffs that CEC is also exploring a biofuel-powered project that would use jatropha. CEC would prefer to buy the jatropha crop from local farmers, rather than take responsibility for jatropha cultivation, but Sindowe acknowledged that this approach could lead to difficulties in having a reliable supply of jatropha feedstock--it needs enough to produce 100,000,000 liters of biofuel.

#### In Mining Ventures Outside the Copperbelt, ZESCO Is In Charge

¶11. (SBU) ZESCO, which in a controversial 2003 ERB decision beat out CEC to win a power line construction contract, built a 330 kV transmission line from Chingola to Solwezi in North Western Province (home of Zambia's "new" Copperbelt) and a sub-station to supply power to the Kansanshi copper mine, which started commercial operations in 2005. Kansanshi asked ZESCO for additional power supply of 100 MW and as a result, ZESCO plans to add a third 330/33 kV (kilovolt) transformer rated at 80 mega-volt amperes (MVA) to the substation, at an expected cost of USD five million. ZESCO also is constructing a 72-kilometer long transmission line from Solwezi to Lumwana and a 330/33 kV substation at the newly-commissioned Lumwana copper mine (which will be Zambia's largest when it starts production in 2008), in order to supply 130 MVA to Lumwana. To serve a new nickel mine in the Southern Province, ZESCO will build a 25 kilometer, 33 kV line from Kafue to Mazabuka at an approximate cost of USD 2.2 million.

¶12. Comment: ZESCO's track record in completing transmission projects appears somewhat more successful than in other areas (namely, generation and retail distribution), perhaps as a result of

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competitive pressure from CEC. If CEC wins approval to develop the Kafue Gorge Lower hydropower project, one potential benefit will be increased competitive pressure in the generation sector from a local service provider.

KOPLOVSKY